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SUBJECT: ARMENIA SEEKS TO END ARMENTEL MONOPOLY

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SUMMARY

1. (SBU) In eleventh-hour negotiations to reach an agreement in the Armentel dispute, Minister of Justice David Harutiunian agreed to put off the June 30 deadline for reaching a settlement until September 28, 2004. Despite the extension, the government's threat still stands: If the sides do not reach agreement by September 28, the Ministry of Transport and Communication (MOTC) intends to unilaterally replace Armentel's monopoly license with a more restricted concession allowing competing service suppliers to provide mobile and international data transmission services. Vahe Yacoubian, Amcit special advisor to the Minister, told us that the government had made progress in the negotiations, and was confident that Armentel will acquiesce to its demand for the introduction of a second GSM service provider. The government believes that competition will end the poor service and high cost in telecommunications that burden consumers and the Armenian economy. END SUMMARY

GOVERNMENT SEEKS SETTLEMENT ENDING MONOPOLY

2. (SBU) Whether by mutual agreement or by unilateral action, the Armenian government intends to end Armentel's monopoly in the provision of GSM mobile services and international data transmission. According to Gevorg Gvoryan, Head of Telecommunications Department at the MOTC, the Government is seeking a settlement with Armentel that permits other service suppliers to provide public mobile services (including cellular telephone service, paging personal communication services, specialized mobile radio, GSM and mobile satellite services) as well as local and international data transmission including international upload and download services. Yacoubian believes that settlement is possible because Armentel management has agreed in principle to a second license for GSM services, with Armentel and the Government splitting the proceeds from the tender. In an effort to "facilitate the negotiations", Yacoubian moved the deadline for agreement to September 28, 2004. If Armentel and the government have not reached agreement by then, Yacoubian said that the government will immediately amend Armentel's license to provide for competition in GSM and data transmission services and will promptly offer licenses to competing service suppliers.

ARBITRATION TO CONTINUE CONCURRENTLY WITH NEGOTIATION

3. (SBU) While Yacoubian said that a settlement is preferable to ongoing arbitration (probably followed by litigation in Armenian courts), both sides are nevertheless pursuing their case scheduled for September 6 before a London arbitration panel. Yacoubian expects that the sides will complete arbitration, but will ask the arbitrator to withhold the decision if the sides reach an agreement. Comment: The extension of the settlement deadline to a date after the arbitration increases the likelihood of a workable settlement and, in the other event, provides the basis for more informed unilateral action by the government. Yacoubian commented that the government intends to seek Armentel's comments on the amended license and the draft Telecommunications Law, which had been prepared without input from Armentel due to the dispute. Armentel's acceptance of the outcome is critical to a successful market, as ultimately Armentel will have the dominant market position and will maintain control of the non-liberalized communications infrastructure. Any additional mobile license would require Armentel's cooperation for interchange with fixed line and mobile subscribers. The arbitration process will also likely give the government an idea of the

scope of damages they may face for unilaterally depriving Armentel of its monopoly license. Yacoubian had earlier told the Ambassador that the government intends to offer Armentel the proceeds of the sale of a new mobile service license to Armentel as compensation. He again confirmed the GOAM's intention to do this, and added that part of the OTE's opening negotiating approach was to ask "how much" of the license sale's proceeds the GOAM was prepared to provide in compensation. End Comment

GOAM NOT PREPARED TO ISSUE ADDITIONAL LICENSES

14. (SBU) Even were the government to amend Armentel's monopoly license on July 1, the regulatory framework is not yet ready for a competitive telecommunications market. To suspend Armentel's exclusive license is not the same thing as issuing new licenses to competing service providers. Asked whether changing the license is legally sufficient to permit a tender offer or the solicitation of licenses by would-be Internet service providers, Gvorgyan replied, "In theory, yes". Armenia's General Agreement on Trade in Services (GATS) schedule contains a specific commitment to provide "unlimited market access for any and all basic and value-added telecom services subsector initially covered by the monopoly immediately upon suspension or termination of monopoly rights...." In fact, many other conditions have to be met. Armentel is principally regulated not by law but by its license. To issue new licenses in a liberalized market the MOTC would have to establish a regulatory framework allowing for multiple service providers, as well as some competition safeguards to prevent Armentel from abusing its dominant position when competing in liberalized sectors. Gvorgyan claims that the MOTC is not ready to regulate a liberalized market in telecommunications and data transmission until licensing procedures are established and the draft Law on Electronic Communication passes.

GOAM NEGOTIATING WITH WOULD-BE MOBILE SERVICE PROVIDERS

15. (SBU) Yacoubian conceded that it was still unclear how a new mobile telephony license would be issued. Yacoubian said that ideally, there would be a public tender, but if there was not enough interest he said that the government would "have a beauty contest" and pick the best candidate. The MOTC's Director of International Relations, Gagik Grigoryan said that "many" service providers had already approached the Ministry about providing service, and that the Ministry was engaging in "preliminary negotiations". When asked directly he confirmed information from another source that a Russian telecommunications company Zont Holding has been negotiating with the Ministry about bidding on a mobile telephony license. When asked if an interested company should wait for a public tender offer or if they could approach the Ministry directly, Gvorgyan suggested that they approach him at the Ministry any time. Asked whether a tender would be only for GSM or would allow for open standards, Gvorgyan replied that the government had not yet made a decision but that he suspected they would "follow Western Europe."

REGULATORY AUTHORITY TO MOVE FROM MINISTRY TO COMMISSION

16. (SBU) The draft Law on Telecommunication will deprive the MOTC of the authority to regulate in the telecommunications sector, and will endow the Public Services Regulatory Commission for (PSRC) with that power. (Note: the law has passed its first reading, and will likely pass in September. End Note.) Gvorgyan added that at that point the Ministry will cease to issue licenses and will become strictly a policy-making body. The PSRC, which currently regulates water and electricity distribution, will undertake to set the legal and regulatory framework for telecommunications licensing and will implement competition and universal service safeguards. (Note: USAID's Commercial Law and Economic Reform Program is currently giving technical assistance to the PSRC. End Note.)

CURRENT TELECOMMUNICATION SYSTEM STYMIES GROWTH

17. (SBU) Armenian businesses (and the general public) complain that the high cost and poor service of telecommunications service stymie growth in Armenia, especially in the emerging IT sector. Armenia's IT comprises more than 100 firms employing 3,500 people and generating US 50 million in annual revenue. Because nearly all these firms are cost centers for foreign IT development companies, reliable and inexpensive international communications are essential to the competitiveness of the

industry. While large companies have been able to establish their own satellite link with their home offices, industry managers consistently cite the dependence on Armentel as the greatest impediment to growth in the industry as a whole.

BACKGROUND ON ARMENTEL DISPUTE

18. (U) In March 1998, Greek telecommunications company OTE invested USD 142.5 million for a 90 percent equity stake in Armentel, giving it the exclusive right to provide all telecommunications services in Armenia, including exclusive public fixed switched technology, mobile telephony, broadband, Internet and directory services until 2013. In return, OTE agreed to support Armentel in developing and expanding the telecommunications infrastructure in Armenia, including digitizing the public switched telephone network and providing for mobile GSM coverage throughout the territory of Armenia.

19. (U) In February 2000, the Republic of Armenia filed a petition for arbitration with the International Court of Arbitration of the International Chamber of Commerce alleging the non-fulfillment of OTE's investment obligations as prescribed in Armentel's share purchase agreement. OTE had an obligation to invest at least USD 100 million before March 2000. The Government of Armenia eventually walked away from this initial claim and the parties reached an agreement that OTE would invest a further USD 65 million. OTE claims that it has invested USD 200 million in Armentel up to March 2003. The Government of Armenia claims that this number is grossly inflated and refuses to recognize much of the claimed investment.

10. (U) In May 2003 the Ministry of Transport and Communication again initiated a claim that investment that OTE and Armentel had failed to meet their investment commitments--specifically not achieving the prescribed teledensity requirements, the investment program, Internet and data transmission upgrades, and for not meeting the mobile telephony coverage commitments on time. OTE counterclaimed, and Armentel commenced separate ICC arbitration proceedings against the GOAM, arguing that OTE and Armentel have suffered losses because the GOAM prevented Armentel from exercising its exclusive rights and from charging call-rates as provided for in the license. Both cases are currently pending before the Arbitration panel in London.

11. (U) Since 2002, Armentel has been financing its investment plan exclusively from operating revenues, without support from OTE. Armentel's operating revenues for the first quarter of 2004 amounted to Euro 17.6 million, while net income for the quarter was Euro 2.4 million, while the number of mobile customers is up 58.7 percent to 131,237. Armentel mobile service is vastly oversubscribed. New SIM cards are not available; black market SIM cards sell for up to USD 300. The service for those who do have SIM cards is poor and unreliable. OTE's quarterly report states that OTE will not fund any further capital requirements in Armentel and is trying to exit the Armenian market.

CONCLUSION

12. (SBU) The current state of the telecommunications system in Armenia is unsatisfactory. Poor service and high cost stymie growth and burden consumers. For three years Armenia's monopoly telecommunications provider and the government have been locked in a stalemate where the service supplier refuses to invest more in infrastructure because it intends to exit the market and the government threatens to deprive it of its monopoly. Now the government looks set to liberalize important telecommunications subsectors, specifically public mobile communications and international data transmission.

COMMENT

13. (SBU) While any competition will likely improve service and reduce prices to consumers, it is incumbent on Armenia to liberalize the sector in a way that will generate true competition and will comply with Armenia's WTO obligations. It is not clear that Armenia is off to a good start. Premature negotiating with would-be service providers suggests that the GOAM may not intend to have a transparent and non-discriminatory tender for new service supplier licenses, but rather cut a back-room deal before an official tender is announced. Yacoubian, however, made clear that he understands the damage a non-transparent, self-serving process would do. It is also not clear when the government will transfer regulatory authority to the PSRC. Gvorgyan

claims that the Ministry is keen to transfer its regulatory power, and that it will be complete in September. Our USAID contractor claims that the Ministry has tacitly fought the transfer as well as the Armentel license change because certain officials have a cozy and profitable relationship with Armentel, although we cannot independently confirm this allegation. Sources close to the Commission suggest that the PSRC is in any case ill-equipped to provide transparent and non-discriminatory regulation of the liberalized market while preventing abuse of position by Armentel and maintaining universal service guarantees.

ORDWAY